



SBA Procedural Notice

TO: All Employees

CONTROL NO.: 5000-1065

SUBJECT: Additional Requirements when a 504 Borrower's Equity Contribution Contains Borrowed Funds

EFFECTIVE: 8/1/2008

The purpose of this Notice is to temporarily modify U.S. Small Business Administration (SBA) policy for 504 loan transactions where the borrower's equity contribution is borrowed. A common example of this is the use of the proceeds of a Home Equity Line of Credit (HELOC) loan as all or part of the borrower's equity contribution. SBA's SOP 50 10(5)-Lender and Development Company Loan Programs, Subpart C, Chapter 1, Paragraph 3.c.(7) states the following:

- (7) If the borrower's equity contribution is borrowed:
- (a) Any lien position on the Project Property must be subordinate to the 504 loan;
 - (b) The borrower may not pay the loan for the equity contribution at a faster rate than the 504 loan ([13 Code of Federal Regulations \(CFR\) 120.912](#)); and
 - (c) If the borrowed equity is collateralized by assets other than the Project Property, the borrower must demonstrate repayment of the loan for the equity contribution from sources other than the cash flow of the business. (Note: The salary of the business owner does not qualify.)

This Notice will temporarily suspend the implementation of provision (c) above until April 30, 2009. SBA intends to study this issue and provide guidance as necessary prior to the expiration of the nine month period.

For a period of 6 months, The Sacramento Loan Processing Center (SLPC) will collect data on all 504 loan applications where any portion of the applicant's equity contribution is borrowed. Therefore, the following procedures will be in place for 6 months beginning on August 18, 2008:

1. The Certified Development Company (CDC) must determine whether any portion of the equity injection is borrowed, and, if so, ask the applicant if there is an additional source of repayment other than the funds from the applicant business that could be used to repay the borrowed equity
2. SBA will collect the source of equity injection information for all loans where any portion of the equity injection is borrowed.

SBA will develop a database that provides information on the portion of the portfolio that does not provide a 10 percent or greater equity injection in the form of cash. The industry has asserted to SBA that there are a number of businesses that have ample cash flow and such a

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sound financial position that making a loan that is essentially 100 percent financing does not present an unacceptable risk. The collection of this information on the borrowed equity will permit the Office of Financial Assistance and the Office of Credit Risk Management to develop an understanding of the scope of this issue and provide the Agency with the background necessary to develop appropriate policy.

For questions concerning this Notice, please contact A. B. McConnell, Jr, Chief, 504 Program Branch at (202) 205-7238 or by email at andrew.mcconnell@sba.gov.

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